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Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Leslye Corsiglia

SUBJECT: Housing Investments
(Council Referral # 12-19-00-9g)

DATE: April 30, 2001

Approved

Date

5.09.01

INFORMATION

BACKGROUND

At its December 19, 2000 meeting, the City Council accepted the staff report regarding the Northside Senior Housing development and directed the Administration to come back to the City Council with information regarding the availability of operating and maintenance (O&M) funding for similar projects as a means of protecting the City's long-term investments.

ANALYSIS

Since its creation in 1988, the Housing Department has provided financing to 124 housing developments. The Department's Loan Management Division oversees the more than 10,000 units included in these developments.

To manage this large portfolio, the Department has instituted a number of requirements and processes, as described below. These processes are similar to those used by private sector lenders.

Underwriting Review—the Department carefully underwrites applications from developers to ensure that, once constructed, a project can continue to operate with the ongoing revenue being projected. A proforma is developed that shows anticipated revenues from unit rents and other miscellaneous sources (laundry room fees), and anticipated costs to operate the project and service any debt. The Department requires that adequate reserves for regular and ongoing maintenance be a part of the budget.

Most projects financed by the City include financing from other sources. These sources are also concerned about their asset, and require that budgets include funding for operations and maintenance. As an example, the State of California's Tax Credit Allocation Committee (TCAC), which is an important source of leverage for many San Jose developments, requires that developers include minimum expense budgets per unit for projects using tax credit equity as a

requires that developers include minimum expense budgets per unit for projects using tax credit equity as a source of financing. Expense budgets are also reviewed and approved by other interested parties to the deal, including the property management company, the bond underwriter or conventional financing lender, the tax credit equity investor and syndicator, the sponsor (developer), the nonprofit general partner, and the financial consultants to the borrower. This process provides assurances that the project will generate sufficient cash flow to cover O&M expenses and repay debt.

Management Plan. The Department requires that developers prepare and submit a management plan for each development at the time of initial application. A standard checklist is provided to serve as a guide in developing the management plan to help ensure appropriate management practices are being followed (see attached).

Loan Management. After project completion, a series of actions is conducted by the Housing Department's Loan Management Division (LMD) to monitor the status of projects in the portfolio. These actions include:

1. **Annual Review.** Annually, project revenues and expenditures are audited to determine if the source and use of funds is consistent with established budget levels for ongoing operating costs and replacement reserves for major scheduled repairs. Any substantive variances are explored and pursued by the LMD staff.
2. **Recertifications.** As a part of the annual review, income recertifications are performed to ensure that the people living in the development continue to be income-eligible according to the requirements of the project loan documents. To complete the recertification process, the project rents are reviewed for compliance with the loan documents. Also, other indicators of project solvency are reviewed, such as the payment of property taxes and the provision of adequate insurance coverage.
3. **Regular Inspections.** The Department has a full-time inspector on staff to conduct regular inspections of large developments to ensure that the City's assets are being appropriately maintained. All projects are subject to a one- to three-year inspection schedule, the timing of which depends on funding sources and applicable regulations. (For example, projects funded with HOME Investment Partnership funding must be inspected annually as required by the U.S. Department of Housing and Urban Development.) The adequacy of maintenance funding is reviewed during this inspection process.

Remedies. When substantive O&M budget variances are discovered during the monitoring process, a number of remedies can be pursued, as follows:

1. **Negotiations with Property Manager.** The first remedy is to initiate discussions with the property manager to determine if the costs are justified. Adjustments can then be made to the budgeted levels of the O&M accounts. If necessary, an independent audit of the project's financials is ordered to clarify the disposition of project funds.
2. **Replacement of the Property Manager.** If there are serious concerns about a property management company's ability to abide by loan requirements, the

provisions of the City's loan documents allow the Department to require that the sponsor/owner replace the property manager (this is a standard feature of commercial loans).

3. Restructuring of the Loan. When operational deficiencies impact loan repayments, the Department can work with the developer to restructure the loan terms, depending on the circumstances of the cash-flow shortfalls.
4. Foreclosure/Deed in Lieu. From our experience, the justification for a project's inability to make loan payments is usually reasonable. However, should it be unreasonable, the remedy of last resort to a monetary default is to foreclose on the loan or accept the deed to the property in lieu of foreclosure.

CONCLUSION

The Housing Department uses industry-wide practices to protect the investment of the City's affordable housing funds. Initial O&M budget standards are set for each project and ongoing measures are taken to monitor the development over time. Remedies are available and are pursued as necessary.

COORDINATION

This memorandum was coordinated with the Office of the City Attorney.


LESLEYE CORSIGLIA
Acting Director of Housing

Attachment